

June 1, 2003

To the Citizens of Redmond, Washington:

The Comprehensive Annual Financial Report of the City of Redmond for the fiscal year ended December 31, 2002, is submitted herewith. We believe the information, as presented, is accurate in all material aspects; that it is presented in a manner designed to set forth fairly the financial position and results of operations of the City as measured and reported by the financial activity of its various funds; and that all disclosures necessary to enable the reader to gain an adequate understanding of the City's financial affairs have been included. Responsibility for both the accuracy of the data, and the completeness and fairness of the presentation, including all disclosures, rests with city management.

The report was prepared by the City's Finance Department in accordance with generally accepted accounting principles (GAAP) and is intended to provide sufficient information to permit the assessment of stewardship and accountability, to demonstrate legal compliance, and to provide management control.

The report includes all funds, account groups, agencies, and boards and commissions that are controlled by, or dependent on, the City's executive and legislative departments. Included as part of the reporting entity is the Redmond Public Corporation, over which the City Council has control.

Cities and counties of the State of Washington must comply with the Budgeting, Accounting and Reporting System (BARS) prescribed by the Office of the State Auditor. State law also provides for an annual independent audit by the Office of the State Auditor and requires timely submission of annual financial reports to the State for review.

As a recipient of federal, state and county financial assistance the City is required to undergo an annual single audit in conformity with the provisions of the Single Audit Act Amendments of 1996 and Budget Circular A-133, *Audits of State and Local Governments*. This audit is conducted by the State Auditor's Office in conjunction with the City's annual independent audit. The results of the City's single annual audit for the fiscal year ended December 31, 2002 provided no instances of material

weaknesses in the internal control structure or significant violations of applicable laws and regulations.

In developing and evaluating the City's accounting control system, consideration is given to the adequacy of internal accounting controls. Accounting control comprises the plan of organization and procedures and records that are concerned with the safeguarding of assets and the reliability of financial records and consequently are designed to provide reasonable assurance that:

Transactions are executed in accordance with management's general or specific authorization.

Transactions are recorded as necessary (1) to permit preparation of financial statements in conformity with (GAAP), or any other criteria, such as finance-related legal and contractual compliance requirements applicable to such statements, and (2) to maintain accountability for assets.

Access to assets is permitted only in accordance with management's authorization.

The recorded accountability for assets is compared with existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

The definition of accounting control assumes reasonable, but not absolute, assurance that the objectives expressed in it will be accomplished by the system. The concept of reasonable assurance recognizes that the cost of internal control should not exceed the benefits expected to be derived.

We believe that the City's internal accounting controls adequately safeguard assets and provide reasonable assurance of proper recording of financial transactions.

GAAP requires that management provide a narrative introduction, overview and analysis to accompany the basic financial statements in the form of *Management's Discussion and Analysis (MD&A)*. This letter of transmittal is designed to complement the MD&A and

should be read in conjunction with it. The City of Redmond's MD&A can be found immediately following the independent auditor's report.

Profile of the Government

Redmond is a non-charter code city, operating under Section 35A of the Revised Code of Washington. It has a Mayor/Council form of government. The Mayor and the seven member City Council are elected for staggered four-year terms and are elected at-large, rather than by district. Members of the City Council are responsible for establishing the general direction and policies for the City and for providing the resources necessary to carry out those policies. As the City's chief administrator, the Mayor is responsible for carrying out the policy and direction set by the City Council. This includes the enforcement of laws and ordinances, the execution of contracts and agreements, and maintenance of peace and order in the city.

The City of Redmond provides a full range of municipal services, including police and fire, emergency medical services, planning and zoning, street maintenance and construction, parks and recreation, and general administrative services. The City operates enterprise funds for water and wastewater services and stormwater management.

The City prepares budgets on the modified accrual basis in accordance with the Revised Code of Washington (RCW) 35A.33. Biennial budgets are adopted by the City Council for funds providing customary government services. Each biennium begins with an odd numbered year. Reviews are conducted at mid-biennium and any changes for the second half of the biennium are adopted by the City Council.

The LID Control and LID Guaranty Debt Service Funds, LID Construction Capital Project Fund, and custodial agency funds, however, are not budgeted. Enterprise and internal service fund budgets are for management control only and are, therefore, not included in this report.

A budget increase or decrease to a fund must be authorized by the City Council, while appropriation changes within a fund may be authorized by the Mayor. All budgets are controlled on a departmental basis. Estimated purchase order amounts are encumbered prior to the release of the order to the supplier. Such encumbrances also serve to provide an additional measure of budgetary control. Open encumbrances are canceled at

the end of the biennium and must be reappropriated in the next biennium's operating budget.

Incorporated in 1912, Redmond is the fifteenth largest city in the state of Washington encompassing an area of 16.64 square miles east of downtown Seattle on the east side of Lake Washington. Redmond has grown from a population of 1,453 in 1960 to a 2002 population of 46,040.

Factors Affecting Financial Condition

Information presented in the financial statements is best considered in the broader context of the economic environment in Redmond and the surrounding area.

Local Economy

Redmond has undergone a number of dramatic changes in the past twenty years. A small town that had its origins in logging and farming has evolved into a city of high tech and light manufacturing, business parks, and an expanding retail core. It has become an employment center that has attracted many new and growing companies whose varied employment opportunities provide a hedge against high levels of unemployment. Microsoft, the biggest high tech employer in Redmond, was largely insulated from the downturn in this industry and did not experience the layoffs common to other high tech companies. Retail employment opportunities increased with the 2002 opening of Home Depot and Fred Meyer on the east side of Redmond. The Bon Marche is scheduled to open a new store in Redmond in 2003. Other employers with a significant presence in Redmond include Safeco Insurance, AT&T, United Parcel Service, and the Lake Washington School District, headquartered at Redmond Town Center.

The decade of the 1990's, particularly the latter half, brought unprecedented growth to Redmond. By the end of the decade, 87% of the commercial growth target for 2012, set in the mid 1990's, had been reached. The city was challenged during this growth spurt to keep up with its infrastructure and service needs. By 2001, growth in Redmond had slowed to a more manageable pace, giving the city time to assess its current position and plan for the future.

Redmond has a strong, diversified economic environment and an educated labor force set in an attractive physical location. The city is known throughout the Pacific Northwest as a great place to raise a family and expand a business. Despite the changes brought about by twenty

years of rapid growth, Redmond has continued to value its unique natural environment. The result is a community whose economy is based upon high technology and light industry, where neighborhoods, parks and businesses fit together.

Long-term Financial Planning

Several long-term capital projects are underway in Redmond. One of the most significant is the City Campus Project to address the shortage of work space for city staff. Financing options are currently under consideration by the City Council. Consolidating city staff from six buildings to one building to provide centralized, efficient service is the focus of this project.

The city water/wastewater utility has undertaken a long-term project to rehabilitate the city's wells. About 35 to 40 percent of the city's water is provided by five wells with the remaining water needs filled through purchased water from Seattle. The wells will be rehabilitated on a rotating basis, keeping at least three wells in service at all times.

Transportation improvements are ongoing with phase 2 of the West Lake Sammamish Parkway widening slated to begin in 2003. This project adds two traffic lanes and a bike lane to the primary north/south traffic route into and out of the southwest side of downtown Redmond.

As Redmond moves forward, economic indicators will be continually monitored and adjustments to city spending and services made to maintain the city's financial health. At the same time, long-term plans are focused on ensuring an economically strong and viable city.

Cash Management

The City invests only in securities authorized by State law, and primarily purchases certificates of deposit and obligations of both the U.S. Government and government sponsored agencies. As stated in the City's investment policy, the primary objectives of investment activities are safety, liquidity, then yield.

The safety of the City's investment portfolio is provided through the diversification and quality of investments purchased, as well as the use of a delivery-versus-payment method for settlement of any transactions. To further ensure the safety of the City's investments, all securities are held and transactions processed by the custodial agent, Union Bank of California.

Liquidity is maintained by attempting to match investment maturities with cash flow requirements, limiting maturities to five years for general operating funds, and keeping a balance in the Local Government Investment Pool sufficient to meet short-term obligations. The Local Government Investment Pool is a state-managed account, which provides local governments with an efficient way to invest short-term and offers almost immediate cash availability. It operates similarly to a commercial money market account.

Yield is considered after safety and liquidity requirements have been met. The City's yield objective is to obtain at least a market rate of return. The basis used to determine whether market yields are being achieved is a comparison between the two year average of the two year Treasury Note and the average rate of return on the City's portfolio.

Risk Management

The City's Risk Manager develops and implements risk management policies and programs to establish a clearly defined risk management structure. The primary goal is to control the City's risk exposures and losses in order to protect the City's financial resources, ensure employees, citizens and visitors a safe environment in which to work and live, and to reduce the cost of insurance. As part of this goal, self-insurance is currently utilized as an alternative to conventional insurance in the areas of health care, Workmen's Compensation and establishing the deductible for property losses. The Risk Manager considers available financial resources and purchases insurance for appropriate excess protection. The Risk Manager also serves as a general advisor to all departments on risk management issues such as identifying and evaluating potential risks, providing employee accident control training, loss reporting and addressing City Safety Committee concerns.

Other Information

Independent Audit

State statute requires an annual audit by the Washington State Auditor's Office. In addition to meeting the requirements set forth in state statutes, the audit also was designed to meet the requirements of the Federal Single Audit Act of 1984 as amended in 1996 and related Office of Management and Budget Circular A-133. The auditor's opinion letter on the general-purpose financial statements is included in the financial section of this report. The complete auditor's report is available at the Redmond City Clerk's office.

Awards

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Redmond for its Comprehensive Annual Financial Report for the fiscal year ended December 31, 2001. This was the seventeenth consecutive year that the government has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current comprehensive annual financial report continues to meet the Certificate of Achievement Program requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

Acknowledgments

The preparation of the Comprehensive Annual Financial Report on a timely basis could not have been accomplished without the efforts and dedication of the staff of the Finance Department. I would like to express my appreciation to my staff and other personnel from various departments and agencies who assisted in its preparation. Also, I would like to thank the Mayor and the City Council for their continued interest and support in planning and conducting the financial operations of the City in a dedicated and responsible manner.

Respectfully submitted,

Lenda Crawford
Finance Director